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# *In brief*

## A look at current financial reporting issues

21 December 2017

### *IFRS IC decision on interest and penalties related to income taxes*

*This In brief supersedes and updates In brief INT2017-12 'IFRS IC decision on interest and penalties related to income taxes'*

#### *Issue*

The IFRS Interpretations Committee (IC) issued an agenda decision in September 2017 on interest and penalties related to income taxes.

IFRIC 23, 'Uncertainty over income tax treatments', applies to income taxes within the scope of IAS 12, 'Income taxes'. It does not address the accounting for interest and penalties related to income taxes. The IC considered whether it should develop guidance and concluded that the benefits of improvements in financial reporting from a project to consider interest and penalties would not outweigh the costs. It therefore decided that it should not develop guidance, and it issued an agenda decision.

The IC observed in the agenda decision that entities do not have an accounting policy choice between applying IAS 12 and applying IAS 37, 'Provisions, contingent liabilities and contingent assets', to interest and penalties. If an entity considers that a particular amount payable or receivable for interest and penalties is an income tax, IAS 12 is applied to that amount. If an entity does not apply IAS 12 to an amount payable or receivable for interest and penalties, it applies IAS 37 to that amount.

The IC also observed that:

- an entity discloses its judgement in this respect applying paragraph 122 of IAS 1, 'Presentation of financial statements', if it has a significant effect on the amounts recognised in the financial statements; and
- regardless of whether an entity applies IAS 12 or IAS 37 when accounting for interest and penalties, the entity discloses information about those items if material, because both IAS 12 and IAS 37 provide disclosure requirements.

#### *Impact*

##### *Who might be affected?*

Any entities that receive or pay interest or penalties related to income taxes might be affected by the agenda decision.

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### *What is the impact?*

In the absence of specific guidance in IAS 12, some entities might currently make an accounting policy choice to determine whether IAS 12 or IAS 37 is applied to interest and penalties related to income tax where there are uncertain tax positions. These entities will now need to consider the specific nature of the interest and penalties to determine which standard applies. This might lead to recognition, measurement and disclosure differences in some cases and to a change in income statement presentation.

### *When is the agenda decision effective?*

The agenda decision clarifies the existing guidance and is therefore effective immediately. Entities with a reporting date shortly after the agenda decision was issued should assess whether the agenda decision applies at that date. The views of any relevant securities regulator should be considered as part of that assessment.

### *What should entities do?*

Affected entities should assess their approach to accounting for interest and penalties related to income taxes, and whether their accounting policies and presentation need to be changed. A change in accounting policy should be accounted for retrospectively in accordance with IAS 8, 'Accounting policies, changes in accounting estimates and errors'.

### *Insight*

Entities need to decide whether a particular amount payable or receivable for interest and penalties is an income tax. IC agenda decisions in **March 2006** and **May 2009** noted that IAS 12 defines income taxes as taxes that are based on taxable profits, and the term 'taxable profit' implies a notion of a net rather than a gross amount.

Judgement is required to determine which standard applies. Management should consider the substance and intent of the tax law and the settlement process with the tax authority to determine whether interest and penalties are separate components that are accounted for by applying IAS 37 or part of an overall settlement with the tax authority that is accounted for by applying IAS 12.

The relevant standard should be applied consistently to all aspects of the accounting.

- The guidance in IAS 12 (and IFRIC 23 with effect from 1 January 2019) should be applied to determine the unit of account, and to the recognition and measurement of amounts that are in the scope of that standard. This would include, for example, recognising current taxes outside of profit or loss if they relate to items recognised outside profit or loss and applying the entity's accounting policy to discounting current tax balances.
- Amounts determined to be in the scope of IAS 37 will be recognised and measured in accordance with that standard. Interest determined to be in the scope of IAS 37 will be recognised as finance cost, and penalties will be recorded as operating expenses.

Management should disclose clearly in accordance with IAS 1 the standard that has been applied to interest and penalties if the impact is material.

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*Where can entities find more details?*

See the September 2017 IFRIC Update for the full agenda decision:

[www.ifrs.org/news-and-events/updates/ifric-updates/september-2017](http://www.ifrs.org/news-and-events/updates/ifric-updates/september-2017).



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